

**THE PUBLIC SERVICE COMMISSION
OF SOUTH CAROLINA**

DOCKET NO. 2017-292-WS

In the Matter of)	
)	DIRECT TESTIMONY
Application of Carolina Water Service,)	
Inc. for an Adjustment of Rates and)	OF
Charges and Modifications to Certain)	
Terms and Conditions for the Provision of)	ROBERT M. HUNTER
Water and Sewer Service)	

1 **Q. PLEASE STATE YOUR NAME, PRESENT POSITION, AND BUSINESS**

2 **ADDRESS.**

3 **A. My name is Robert M. Hunter. I am the Financial Planning and Analysis Manager for**
 4 **Carolina Water Service, Inc. (“CWS” or “Company”). My business address is 150 Foster Brother**
 5 **Drive, West Columbia, SC 29172.**

6 **Q. WHAT ARE YOUR DUTIES IN YOUR CURRENT POSITION?**

7 **A. As Financial Planning and Analysis Manager, I am responsible for the daily management**
 8 **of all state level accounting and finance operations. I perform financial and business-related**
 9 **analyses and research in areas such as expense trends, rate of return, depreciation, working capital**
 10 **and investments at the state level. My duties and responsibilities include:**

- 11 • Managing the annual financial budgeting process for the Company,
- 12 • Analyzing budget and forecast variances and year-over-year variances to provide
- 13 • explanations to management, and to assist with financial decision-making,
- 14 • Managing and reporting monthly capital spending and forecasting,
- 15 • Handling the regulatory process for matters requiring governmental approval, including
- 16 • filing necessary applications,
- 17 • Utilizing internal databases and other tools to support qualitative and quantitative analyses
- 18 • and metrics for the Company, and

- Supporting Company accounting principles, practices, and procedures.

Q. WHAT IS YOUR EDUCATION AND PROFESSIONAL BACKGROUND?

A. I hold bachelor's degrees in Corporate Finance and Business Management from the University of Illinois in Champaign-Urbana. I have worked in finance-related roles for over four years at Utilities, Inc., working most of that time as a Senior Financial Analyst, and currently as a Financial Planning and Analysis Manager for Carolina Water Service. Before joining Utilities, Inc. I worked as an Investments Analyst for Ocean Tomo, a firm providing Opinion, Management and Advisory services centered on intellectual property assets. While there, I performed market research on a wide array of industries and analyzed company financials to create financial models to determine lost profits and reasonable royalty damages in preparation for patent infringement litigation.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to sponsor CWS's application for an adjustment of certain rates and charges for the provision of water and sewer services ("the Rate Case Application" or "the Application").

Q. WHY IS CWS REQUESTING RATE RELIEF AT THIS TIME?

A. With the increase in operating expenses and additional plant investments we have made since December of 2014, the end of test year in the last rate case, we cannot earn our authorized rate of return and therefore are requesting rate relief.

Q. PLEASE DESCRIBE THE COMPANY'S APPLICATION.

A. The Rate Case Application includes the financial statements for CWS. The subsections are as follows:

Schedule A – Balance Sheet

Schedule B – Current and Pro Forma Income and Expense Statements

1 Schedule C – Rate Base, Rate of Return Information and Statement of Total Plant
2 Investment

3 Schedule D – Water and Sewer Consumption Analyses

4 Schedule E – Water and Sewer Proposed Revenues

5 Schedule F – Current and Projected Customers

6 Schedule G – Effect of Proposed Rates

7 Included in the Application as Exhibit F, is the Company's proposed Utility System
8 Improvement Rate with example calculations of water and sewer rates. This is a new capital
9 investment recovery mechanism that the Company is seeking approval of as part of this
10 Application.

11 Also included in the Application, are the most recent approval letters from the South
12 Carolina Department of Health and Environmental Control, a sample customer bill form and the
13 Company's most recent Gross Receipts Tax Filing. The test year chosen for this Application is
14 the year ended August 31, 2017.

15 **Q. PLEASE EXPLAIN HOW THE TEST YEAR EXPENSES WERE ADJUSTED.**

16 **A.** Pro forma adjustments were made to the test year expenses based on known and
17 measurable changes to actual expenses at the time of the Application filing.

18 **Q. WHAT ARE THE KNOWN AND MEASURABLE PRO FORMA ADJUSTMENTS**
19 **MADE TO THE CONSOLIDATED INCOME STATEMENT (SCHEDULE B)?**

20 **A.** The following adjustments have been made to the Income Statement:

21 [a] Revenues are annualized to reflect year end customers at current rates. The I-20 Waste-
22 Water System revenues have been removed from the test year in anticipation of losing the
23 Waste-Water system because of the condemnation of that system by the Town of
24 Lexington. The Town of Lexington took possession of the I-20 Waste-Water System on
25 February 1, 2018.

26 [b] Uncollectibles are adjusted at test year percentages for annualized revenues.

- 1 [c] Salaries, wages and benefits are adjusted from test year to current levels. In addition,
2 capitalized time has been adjusted to reflect current capitalized time rates for current
3 employees.
- 4 [d] Regulatory commission expense including attorneys' fees, expert witness fees, and out-of-
5 pocket expenses has been adjusted for the total estimated cost of this case and the
6 unamortized portion of prior rate case amounts.
- 7 [e] Depreciation and amortization are annualized at 1.5% on depreciable/amortizable
8 assets/Contributions in Aid of Construction ("CIAC"). Separate from these assets,
9 depreciation has been calculated and included for computers, vehicles, and other allocated
10 plant.
- 11 [f] Taxes other than income are adjusted to annualize gross receipts, utility or commission
12 taxes, and franchise taxes at present and proposed revenues. Taxes other than income also
13 includes payroll taxes adjusted for annualized salaries. Property Taxes have been adjusted
14 to reflect most updated known and measurable amounts from test year to current levels.
- 15 [g] Income taxes are computed on taxable income at the rates in effect at the time of filing.
- 16 [h] Allowance for Funds Used During Construction ("AFUDC") is eliminated for rate making
17 purposes.
- 18 [i] Interest on debt has been computed using a 51.89%/48.11% equity/debt ratio and a 6.60%
19 cost of debt.
- 20 [j] Non-recoverable items have been removed.
- 21 [k] Revenues are increased to reflect Carolina Water Service's requested incremental revenue
22 adjustment.
- 23 [l] Uncollectibles are adjusted at test year percentages for the requested incremental revenue
24 adjustment.
- 25 [m] Transportation expense has been adjusted to reflect the expense as allocated by driver.
- 26 [n] Sale of Utility Property has been removed for ratemaking purposes.
- 27 [o] Deferred Maintenance expense has been adjusted to include the annual amortization
28 expense anticipated due to the creation of the Deferral Asset account approved in the prior
29 rate case for increases in purchased water rates since the prior rate proceeding.
- 30 [p] Purchased water and waste-water expenses have been adjusted to reflect current expense
31 levels known at the time the Application was filed. Increased expenses due to rate increases
32 from providers has been deferred into the Deferral Asset account since the prior rate case.
33 These adjustments are made to full invoiced amounts.

1 [q] The Income Statement has been adjusted to reflect all changes related to the removal of the
2 I-20 Waste-Water System.

3 **Q. WHAT ARE THE PRO FORMA ADJUSTMENTS MADE TO THE RATE BASE**
4 **STATEMENT (SCHEDULE C)?**

5 **A.** The following adjustments have been made to rate base:

6 [a] Gross plant in service is adjusted to reflect adjusted vehicles, allocated by the various
7 accurate allocation percentages for Carolina Water Service.

8 [b] Per books Accumulated Depreciation and Accumulated Amortization has been adjusted
9 for depreciable assets at 1.5%. Separate from these assets, Accumulated Depreciation has
10 been calculated and included for computers, vehicles and other allocated plant.

11 [c] Cash working capital is calculated based on 1/8 of maintenance and general expenses.

12 [d] A pro forma adjustment has been made to include actual/estimated pro forma plant and
13 general ledger additions.

14 [f] Excess book value has been included for ratemaking purposes.

15 [g] Adjustments have been made to Gross Plant in Service, Accumulated Depreciation, CIAC,
16 Cash Working Capital and Plant Acquisition Adjustment to reflect the removal of the I-20
17 Waste-Water System from CWS.

18 **Q. PLEASE SUMMARIZE THE PROPOSED CHANGES IN THE COMPANY'S**
19 **WATER SERVICE RATE SCHEDULES.**

20 **A.** Exhibit "A" to the Application contains the Company's Schedule of Proposed Water
21 Charges. The proposed water rate structure for Territory 1 and Territory 2 will remain the same
22 as approved in the prior rate case. In Territory 1 and Territory 2 there will remain separate charges
23 for Water Supply Customers (where water is supplied by wells owned and operated by CWS) and
24 Water Distribution Customers (where water is purchased from a governmental body or agency or
25 other entity for distribution and resale by CWS).

1 **Q. CWS ELIMINATED THE “PASS-THROUGH” BILLING OF COMMODITY**
2 **CHARGES FOR ITS WATER DISTRIBUTION CUSTOMERS IN ITS LAST RATE**
3 **CASE. PLEASE DESCRIBE HOW CWS RECOVERS ITS BULK COMMODITY COSTS.**

4 **A.** Since the prior case, CWS has experienced increases in water rates from some of its
5 purchased water providers. Because the “pass-through” billing of commodity charges was
6 removed in the last rate case, CWS has been deferring increased expenses realized due to these
7 rate changes into a Deferral Asset account approved in the last case. In this rate case, CWS has
8 made an adjustment to the test year purchased water expense amount to reflect the current known
9 and measurable expense levels including the impact of rate changes from providers. In addition,
10 CWS will seek recovery of the Deferral Asset account through amortization of the asset.

11 **Q. WHAT IS THE BALANCE IN THE DEFERRED ACCOUNT AND EXPLAIN**
12 **HOW CWS INTENDS TO RECOVER THIS BALANCE?**

13 **A.** As of January 31, 2018, the balance, in the Deferred Asset account is \$616,422. CWS
14 intends to recover the costs in the Deferred Asset account by amortizing the balance over three (3)
15 years beginning on the date approved rates under this application become effective.

16 **Q. PLEASE SUMMARIZE THE PROPOSED CHANGES IN THE COMPANY’S**
17 **SEWER RATE SCHEDULES.**

18 **A.** Exhibit “A” to the Application contains the Company’s Schedule of Proposed Sewer
19 Charges. Under the existing tariff, the flat rate charge for Sewer Collection & Treatment Only
20 Customers and the flat rate charge for Sewer Collection Only Customers are two different rates.
21 CWS proposes to combine Sewer Collection & Treatment Only Customers and Sewer Collection
22 Only Customers into one single rate per unit. Separate rates will remain on the tariff for Mobile
23 Homes, Wholesale Services (Midlands Utility) and The Village Sewer Collection Customers.

1 **Q. WHAT IMPACT DOES THE TAX CUT AND JOBS ACT HAVE ON THE**
2 **COMPANY'S RATE REQUEST IN THIS CASE?**

3 **A. CWS** filed the Application prior to enactment of the Tax Cut and Jobs Act ("the Act"),
4 therefore, the impact of the Act was not included in the filing. Among other things, the Act reduced
5 the corporate income tax rate by 14% from 35% to 21%, which reduces income tax expense. CWS
6 is still evaluating the impact of the changes in the Act including the reduction in the tax rate, and
7 it is therefore difficult to provide a simple line item reduction for just the corporate rate reduction.
8 The Company has provided the Office of Regulatory Staff with information and data pertaining to
9 the impact of the tax rate reductions on this case during the audit process. At this time, the
10 Company estimates the reduction in revenue requirement using the initial Application as a result
11 of the statutory rate change is approximately \$876,640. The problem with using that information
12 in isolation is that it does not take into account increased tax costs CWS also may incur as a result
13 of changes under the Act such as tax on CIAC discussed below.

14 **Q. DOES THE TAX CUT AND JOBS ACT AFFECT RATES IN ANY OTHER WAY?**

15 **A. The Act** also reduces the cost of service to customers due to the amortization of the excess
16 Accumulated Deferred Income Taxes ("ADIT"). ADIT is the difference between the amount of
17 tax recovered in rates and the amount of tax actually paid by the utility. When the tax rate is
18 lowered, a portion of the ADIT will never be paid to the federal government and excess deferred
19 taxes are created. Excess deferred taxes mean the utility charged consumers at a higher tax rate in
20 the early years than the tax actually paid by the utility in the future. Because the excess ADIT will
21 not be paid to the federal government, it should be held in a regulatory liability account until it is
22 determined whether a refund to the ratepayers is appropriate.

23 **Q. HOW IS ADIT COMPUTED?**

1 A. Currently, we use a process called “normalization” in which the Internal Revenue Service
2 (“IRS”) requires specific accounting rules for calculating ADIT. The normalization provisions
3 contained in the Internal Revenue Code (“IRC”) apply to accelerated depreciation, certain excess
4 ADIT due to reductions in income tax rate, and to the investment tax credit.

5 **Q. PLEASE EXPLAIN THE IMPACT OF ACCELERATED DEPRECIATION ON**
6 **THE ADIT COMPUTATION.**

7 A. The accelerated depreciation provisions in the IRC provide incentives to taxpayers for
8 investment, construction, and other economy stimulating activities. Because of accelerated
9 depreciation, the amount of tax paid by the utility is generally less than the taxes recovered from
10 ratepayers in the early years of an asset’s life. In other words, because the customers are paying
11 revenues based on the normal depreciation life, accelerated depreciation of an asset creates a
12 difference between book income and ratemaking income. If an asset’s depreciation is accelerated
13 at the beginning of its life then our book income will be lower (higher depreciation expense), and
14 therefore the income taxes paid thereon are lower. Payment of these lower taxes creates excess
15 ADIT. Assuming the statutory tax rate remains the same over time, later in the asset’s life this
16 would reverse since the asset would become depreciated (lower actual depreciation expense)
17 creating higher book income and higher income taxes. This normalization process is meant to
18 equalize tax liability over the course of an assets life. The normalization rules require that the
19 resulting ADIT be used to reduce rate base or be treated as zero cost capital in the rate of return
20 calculation, providing ratepayers the time value benefit of the interest free loan from the U.S.
21 Treasury.

22 **Q. DOES THE RATEPAYER BENEFIT FROM THE IMPACT OF THE TAX CUT**
23 **ON ADIT?**

1 **A.** Yes. Once the Company determines the appropriate amount of excess ADIT due to tax
2 reform, the ADIT balance will be adjusted and a regulatory liability asset will be created. This
3 regulatory liability will be amortized over the life of the asset. Because of this the customers will
4 see a benefit through a reduction in the Company's revenue requirement. The Company is working
5 with external tax and accounting professionals to determine the appropriate regulatory liability and
6 adjustment to ADIT.

7 **Q.** **WHAT OTHER IMPACT ON RATE MAKING HAS THE TAX CUT AND JOBS**
8 **ACT HAD?**

9 **A.** Another change in tax law affecting the Company concerns property or cash contributed to
10 the Company by developers in aid of construction (CIAC). Prior to the Act, CIAC was not taxable.
11 However, property or cash contributed by developers is now taxable. Ratepayers will benefit if the
12 developer is required to pay the tax on the developer's contribution. Any CIAC (including tap fees)
13 dedicated by the developer will now need to be grossed up by CWS for federal and state taxes, as
14 is currently the practice of electric utilities. The Company plans to make a separate filing with the
15 Commission to update its tariff language to reflect the new tax gross up requirements. There are
16 increased tax costs associated with the elimination of the exemption for CIAC from income tax
17 that should be considered relative to other adjustments in the Tax Reform. For example, any CIAC
18 accepted under prior developer agreements may not provide for collection of this tax from the
19 developer. In addition, in some instances, new infrastructure dedicated by a developer may benefit
20 the entire system providing greater reliability of service and should be considered relative to our
21 overall rates. This is just one reason why attempting to adopt a simple line item reduction based
22 solely on the corporate rate reduction is appropriate.

23 While the ratepayers will benefit from the reduction in the corporate tax rate, CWS will be in

1 a better position to quantify that benefit at a time closer to the hearing in this docket.

2 **Q. WHAT RATEMAKING METHODOLOGY DOES THE COMPANY PROPOSE**
3 **THAT THE COMMISSION EMPLOY IN THIS RATE CASE?**

4 **A.** The Company proposed that its rates continue to be determined utilizing the rate of return
5 on rate base methodology.

6 **Q. WHY DOES CWS NEED THIS RATE INCREASE?**

7 **A.** The proposed rate increase is necessary in order that we may provide reasonable and
8 adequate service to our customers, cover expenses, be permitted an opportunity to earn a
9 reasonable return on investments, and attract capital for future improvements in South Carolina.

10 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

11 **A.** Yes, it does.